CHASE

International Finance

Vol. XVI, No. 6
March 16, 1981

Issued bi-weekly by the Economics Group of The Chase Manhattan Bank
for corporate customers and correspondent banks

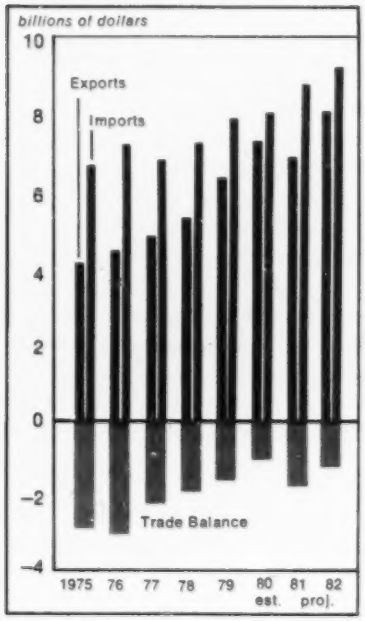
3/17/81
B1900-1 U

Polish Trade Deficit Expected to Widen in 1981

Polish national income declined by 4% last year, the result of widespread labor unrest—which toppled many Party and State leaders—and a sharp drop in agricultural output. Work stoppages and supply disruption caused industrial production in the second half of 1980 to fall 6% below the level prevailing earlier in the year; for the full year, industrial output fell 1.3%. While many important sectors saw production declines after mid year, the impact was particularly severe in coal and was accentuated by changes in work rules following fatal accidents in the mines. Average monthly coal production was 14 million metric tons in the last four months of 1980, well below the 17-million-ton monthly average for the first eight months.

The major blow to Poland's economy in 1980, however, was a disastrous harvest. Crop production fell 15.2% and meat output declined 4.5%. Grain production was up 7.2% from its low level in 1979, but there were major failures in potatoes and in sugar beets. Severe shortages of potatoes and other fodder crops diminished livestock inventories sharply. It now appears that two favorable harvests will be needed to restore livestock numbers and meat production.

Polish trade with non-Socialist countries



An excellent export performance in the first half of 1980 promised a dramatic improvement in Poland's trade balance with the West. But labor troubles in the second half reduced annual export volume by 4.3%. The drop in import volume, primarily the result of transport problems, was a more moderate 2.8%. Still, export revenues in the first half enabled Poland to cut its overall trade deficit with non-Socialist countries nearly in half—to approximately $875 million. The trade balance with Socialist nations shifted into a $1 billion deficit last year, after a small surplus in 1979.

Forecasts of Poland's trade performance in 1981 depend in large part on assumptions about the likelihood of an internal political settlement without a Soviet military intervention. The assumptions here are that the Polish Party Congress, scheduled for the end of this month, will approve a three-year stabilization program acceptable to both workers and peasants; that living standards remain at their current reduced levels; and that investment drops by another 5% this year after a 10.5% contraction in 1980. Under these conditions, and given the further decline anticipated for industrial and animal product output, export volume is forecast to fall by 10% in 1981. Consequently, Poland's hard-currency trade deficit is likely to widen to $1.8 billion.

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U.K. pursues greater convergence of fiscal and monetary policy.

Over the last two years, the British government has been criticized for combining a restrictive monetary stance with a lax fiscal stance. The new U.K. budget represents a determined effort to redress the imbalance. The government has announced a target growth band of 6%-10% for the sterling M3 money stock following last year's target of 7%-11%, but the new band is based on the money supply in February 1981—a month in which M3 lay well above last year's target. Consequently, the new target band constitutes a relatively easy monetary policy. In contrast, the government has budgeted for a huge increase in its tax revenues by raising indirect taxes on gasoline, alcohol, and tobacco and by failing to index income-tax brackets to account for last year's inflation. As a result, the 1981 budget deficit, which looked set to reach 14 billion pounds, is now projected at £10½ billion. The new monetary and fiscal policy mix is expected to boost the rate of inflation somewhat, and an average of 12% is now projected for 1981. The budget should nonetheless provide some scope for a reduction in interest rates and a resulting softening of the exchange value of the pound. Such changes —which have started with the announcement of a cut in the Bank of England's minimum lending rate to 12% from 14%—may give some boost to the economy this year. But they will not be large enough to offset the deflationary impact of the budget. Thus, another decline in GNP is expected in 1981, after last year's contraction of some 2½%.

Canadian GNP turnout in 1980 surprised forecasters.

Contrary to nearly all forecasts, Canadian real GNP ended 1980 with growth of 0.1%. A major reason for the stronger-than-expected level of economic activity was an export surge that brought about a decline in the goods and services deficit in real terms. This provided the Canadian economy with a 2.5% increase in final demand last year, compared with a 1% gain in 1979. Domestic demand in 1980 was also bolstered by unexpected strength in consumer and investment spending. Nonetheless, the growth rate last year was barely positive, with declines registered in inflation-adjusted durable goods sales. For 1981, the consensus forecast calls for real GNP growth of 1%-2%. This is contingent on a U.S. economic recovery and a possible deceleration of inflation and interest-rate pressures in both the United States and Canada.

Swedish strategy seeks reduction in inflation and oil-import dependence.

Recent events indicate that Sweden is making progress toward resolving important structural problems. In agreeing to an average wage rise of 7.1% spread over two years, Swedish workers have settled for pay increases that are well below the current rate of inflation. (The year-over-year rate in January was 13.1%.) The wage pact contains an escalator clause that triggers further pay rises should inflation exceed expectations, but as the negotiators agreed to exclude oil prices from their calculations, chances are that the clause will not be activated. The wage agreement has led the Economics Ministry to revise its 1981 inflation forecast down to 9% and to predict a slight climb in GDP during the year. Looking to the longer term, the government has put forward a program to reduce oil imports from 26 million tons per year to between 14 million and 17 million by 1990. This despite the halt to the development of nuclear power decreed in the referendum of March 1980. The foreign-exchange market has reacted favorably to these developments, and the heavy selling pressure suffered by the kronor earlier this year has now evaporated.

Finnish economy is one of Europe's strongest, but inflation and trade problems have emerged.

Finland is still likely to be one of the few European countries that will record positive economic growth this year, but its economic performance otherwise is converging with the European average. The Finnish inflation rate was a full 3% below the European average in 1979, 2½% below it in 1980, and it is expected to exceed the average in 1981. The acceleration of inflation and higher oil prices have created international payments problems similar to those experienced elsewhere in Europe. The balance of trade worsened from 1.2 billion markkaa in 1979 to 5.85 billion markkaa last year. And higher interest charges on external

debt—which now stands at 16% of GDP—helped widen last year's current-account deficit to 5 billion markkaa from 0.8 billion in 1979. Despite these adverse trends, prospects remain reasonably good, and Finland should be able to avoid the full force of the European recessionary tilt by stepping up its exports to the USSR—from whom it obtains its oil supplies.

Japan's sluggish economy and reduced inflation suggest monetary easing.

Japan's economy continues to be sluggish, with weak consumer spending acting as a drag. Preliminary figures indicate that the unadjusted industrial production index rose just 3.6% in January from its year-earlier level, and corporate bankruptcies reached a record for the month. Year-over-year increases in January for the consumer and wholesale price indexes, however, moderated to 7.4% and 6.7%, respectively. All of this suggests that some relaxation of monetary policy is possible, especially to stimulate consumer spending. Furthermore, the expected appreciation of the yen should cushion the impact on prices of such a move. The questions faced by Japanese policymakers, however, are whether monetary easing can occur without rekindling fears of inflation and whether further appreciation of the yen should be permitted, given the already weak prospects for Japanese exports.

Economic growth in Singapore to stay brisk in 1981, with inflation relatively moderate.

Real GDP growth in Singapore accelerated to 10% last year, up from 9.3% in 1979. Fueled by strong demand for their services and products, the financial and construction industries supplanted manufacturing's position as the leading sector. With internal demand growing faster than domestic exports, Singapore's current-account deficit widened to about $2 billion. But inflows of investment capital more than filled the gap. Consequently, the Singapore dollar appreciated considerably last year, and the rate of consumer price inflation was held below 7%. The outlook this year remains favorable. Economic growth will probably slow somewhat to 8%-9%, but it is expected to be more balanced. The Singapore dollar's appreciation may ease, but declining world inflation should limit the rate of price increase to 6%-7%.

Colombian economic plan aimed at export diversification.

The Colombian economy is poised for strong growth over the next few years, largely because of the expected returns to the country's $20-billion National Plan of Economic Integration. Real economic expansion of some 5% is projected for 1981, up from 4% in 1980, with the growth pace rising to 6% next year. The Plan, implemented just last year, calls for large investment projects in coal and nickel mining and in hydroelectric power, and it emphasizes industrial development and public works improvements. The momentum provided by the program's large undertakings should offset the slowdown in the coffee export sector—attributable to coffee price declines—as well as the weakness in such traditional industries as textiles. By 1983-84, substantial new export revenues are expected to be realized for coal and nickel, which will supplement the sometimes volatile foreign-exchange earnings from Colombia's traditional exports. The new projects should also provide a broader base for sustained economic growth and income gains in Colombia over the longer term.

Lead price weakness forecast, largely the result of lagging auto demand.

Lead prices in 1981 are not expected to rise very much from their mid-January level of 32.1¢ per pound, owing to weak demand, particularly from the automobile sector. World demand is likely to be relatively flat this year, as high interest rates, rising oil prices, and economic recession dampen worldwide automobile sales. U.S. domestic auto production, for example, is projected at less than seven million units in 1981, compared with more than nine million units in 1977 and 1978. Non-Socialist world supply of refined lead is also expected to be flat this year, and inventories are likely to expand for the third consecutive year. Commercial stockpiles are forecast to rise by over 80,000 metric tons in 1981, pushing total inventories to the equivalent of some 1.1 months of consumption—their highest level since 1975. On balance, average lead prices are expected to be in the range of 34¢-36¢ per pound this year, which is well below the total cost of production.

Money Fund Surge Stirs Controversy

Net assets of money market mutual funds (MMFs) have jumped by almost $25 billion since the end of last year, and now total about $100 billion. This surge has intensified demands from some depository institutions that certain measures—such as imposing reserve requirements or limiting the check-writing feature of MMFs—should be taken to curb the growth of the money funds.

MMFs—or open-end investment funds that invest solely in short-term money market instruments—offer shareholders a highly liquid investment vehicle that yields a near-market rate of return. In contrast, commercial banks and thrift institutions are subject to regulatory restrictions on the interest rate they may pay on small deposits and transactions accounts. Moreover, many of these institutions must hold non-interest-bearing reserves against deposits—the equivalent of being assessed a tax on deposits. These differences, combined with the high level of market interest rates, are believed to be one of the major causes of the recent surge in MMF assets.

While the high interest rates of recent years certainly explain much of the *secular* rise in MMF assets, they do not explain *recent* behavior. For example, from last August to December, interest rates *rose* sharply while MMF assets *fell*. And from December to early March, rates *fell* while MMF assets soared.

A major reason for this somewhat paradoxical behavior is that MMF yields generally lag behind changes in market interest rates. This is because most MMFs amortize the return on each instrument held. For example, the current daily yield on a MMF may be based partly on the yield on 30-day commercial paper purchased up to 30 days ago. Thus, when market interest rates rose from last August to December, the yield on money market instruments (as well as that on six-month money market certificates at banks and thrifts) rose relative to that on most MMFs. And when market interest rates began to fall early this year, MMF yields rose relative to market interest rates. The behavior of MMF assets over the same period suggests that the *spread* between MMF yields and market interest rates—and not simply the level of market rates—has had a major effect on MMF asset growth.

An implication is that the imposition of reserve requirements on MMFs would—by increasing the cost of operating a MMF and thereby reducing its relative yield—depress the growth of MMF assets somewhat. However, to the extent that there are shifts among investment vehicles, the chief result would be an increase in direct investment in money market instruments, and not in consumer deposits at depository institutions.

Another Downturn for Housing

After a two-year slide, the rebound of housing construction that began last fall and continued into early winter surprised many analysts. Housing starts fell by 50% to an annual rate of 1.06 million housing units in the second quarter of last year, but residential construction activity regained one-half of this loss by the end of 1980. This pattern is in sharp contrast to the behavior of housing in the 1973-75 recession. Then, the drop-off in starts was only somewhat greater (60% peak-to-trough), but six months after the trough, the recovery was only half as fast. Sharp differences in the cost of financing and in the supply/demand balance in the housing market explain the different patterns between the current cycle and that of 1973-75; they also indicate that another downturn in housing activity is probable.

Despite the relatively high level of housing starts recently, signs of weakness have already appeared. Sales of new homes have fallen more than 10% in the last two months. And turnover of existing homes has tumbled by a quarter since its early-fall peak.

Interest rates are perhaps the most important reason for the current weakness of single-family starts. Rates went from 12% in January 1980 to 14% in May, down to near 12% again in August, and back up to almost 14% in January. In 1975, by contrast, mortgage rates dropped only about ½% from their peak. They then stood stable at this lower level for three years, allowing steady gains in construction and resale activity. Although there is evidence to indicate that homebuyers are becoming inured to higher mortgage rates, the combination of higher rates, reduced availability of loanable funds from thrifts, depressed resale activity, and still-rising house prices seems almost certain to push single-family starts even lower in the months ahead.

The multi-family segment is also set for a downturn. Multi-family starts were an important contributor to last fall's surge in housing starts. While starts of single family units fell 9% in the fall as mortgage rates rose, starts of multi-family units soared 40%. Extreme tightness in many local markets—reflected by a national vacancy rate for rental units of only 4.8%—and continuing support of governmental subsidies for low-income housing spurred new construction of apartments. In contrast, overbuilding of multi-family units in 1972-73 resulted in a vacancy rate above 6% in 1974 and 1975, and almost complete withdrawal of government subsidies depressed the normal cyclical recovery in apartment construction.

The current level of apartment building, however, is far below that of 1972-73, and the low vacancy rate indicates that speculative overbuilding is currently not a problem. Still, the high level of interest rates is likely to dampen multi-family starts at least somewhat. Moreover, the government subsidy programs, which are only about half their size in 1972-73, are scheduled to be trimmed by a quarter, or some 60,000 units.

Africa and Middle East Bimonthly Survey of Business and Finance

COUNTRIES	CURRENT BUSINESS CONDITIONS	EXPORTS: 6 months ending	EXPORTS: change from year earlier	GNP IN 1979: in billions of dollars	GNP IN 1979: per capita	BALANCE OF PAYMENTS: latest data	BALANCE OF PAYMENTS: reserves (less gold) in million $	BALANCE OF PAYMENTS: 12-month change	BALANCE OF PAYMENTS: months of imports covered	BALANCE OF PAYMENTS: use of IMF credit, millions of dollars	BALANCE OF PAYMENTS: current influences on payments	MONEY AND BANKING: 12-month changes: latest data	MONEY AND BANKING: 12-month changes: consumer prices	MONEY AND BANKING: 12-month changes: latest data	MONEY AND BANKING: 12-month changes: money supply(M1)	MONEY AND BANKING: exchange rate in U.S. dollars, March 11, 1981	MONEY AND BANKING: change from year earlier, March 11, 1981	MONEY AND BANKING: current monetary conditions	COUNTRIES
Algeria	Real GDP growth was 3% last year, dampened by reduced oil production.	Nov.	+ 32%	24.6*	$1,374	Jan.	3,676	+ 35%	1.4	0	Hydrocarbon export receipts were $14 bn. in 1980, more than double 1979.	Dec. '79	+ 12%	Dec.'79	+ 18%	.2500	— 3%	European Invest. Bank lends $20 mn. for power stations.	**Algeria**
Cameroon	New liberal investment code encourages private industrial investment.	July	+ 32%	5.0	650	July	194	+134%	1.4	9	Current-account gap could double to $300 million in 1981.	Aug.	+ 14%	July	+ 25%	.004104	—11%	Agricultural credits retain priority.	**Cameroon**
Egypt	Western aid commitments for 1981 put at $2.95 billion, versus $2.5 billion last year.	June	+ 74%	16.4	400	Nov.	1,057	+189%	2.8	173	Twelve new oil discoveries reportedly made in Gulf of Suez last year.	Nov.	+ 19%	Nov.	+ 24%	1.45	0	Money supply expanding steadily.	**Egypt**
Gabon	Oil output forecasts for 1981 lowered to 170,000 bpd, owing to delays in tapping new wells.	Dec.	+ 37%	3.8**	6,900	July	70	— 11%	1.3	14	Trade surplus in 1981 expected to approximate 1980's $1.8 billion.	May	+ 14%	July	+ 10%	.004014	—13%	Credit expansion within IMF ceilings.	**Gabon**
Ivory Coast	Restrictive fiscal policy expected to continue through 1981.	May	— 6%	9.0	1,135	Oct.	19	— 91%	0.1	0	IMF approves $630-million, three-year credit line.	Sept.	+ 10%	June	+ 2%	.004014	—13%	Public enterprises step up bank borrowing.	**Ivory Coast**
Libya	German and Austrian companies awarded $1.3 billion in contracts for steel projects.	Oct.	+ 36%	20.0*	7,270	Sept.	12,158	+135%	17.1	0	LNG exports to Italy cut off in January, owing to disagreement on price.	n.a.	n.a.	Dec.'79	+ 33%	3.42	—	Net foreign assets rising.	**Libya**
Morocco	World Bank to lend $136 million for tourism and housing projects.	Sept.	+ 32%	15.3	788	Dec.	399	— 28%	1.3	309	Phosphate prices averaged $45 per ton last year, up 36% from 1979.	Oct.	+ 12%	Nov.	+ 7%	.2150	—15%	Swiss loan of $51 million obtained for industrial projects.	**Morocco**
Niger	Anticipated reductions in uranium earnings cause cutbacks in investment plans.	Dec.	+ 21%	2.0	390	Jan.	244	+ 78%	2.5	0	Uranium price fall worsens balance-of-payments outlook.	Aug.	+ 11%	July	+ 27%	.004014	—13%	External borrowing set to rise.	**Niger**
Nigeria	Capital budget for 1981 shows modest rise of 17% to $16.5 billion.	Nov.	+ 38%	54.6	700	Jan.	9,974	+ 79%	10.4	0	Imports surge in response to relaxed controls.	Mar.	+ 12%	Aug.	+ 15%	1.79	—	No further credit liberalization expected.	**Nigeria**
South Africa	Manufacturing due for a leveling-off in output and sales; fixed investment to rise.	Dec.	+ 30%	57.3	2,070	Jan.	934	+ 40%	0.5	0	Current account moves into deficit as gold price stays below $500/oz.	Dec.	+ 16%	Nov.	+ 41%	1.2735	+ 3%	Interest rates expected to rise.	**South Africa**
Tunisia	Real economic growth of 7% estimated for 1980, same as in 1979.	Aug.	+ 41%	7.0	1,096	Jan.	528	— 3%	1.7	0	Planned rise in public-sector investment to boost capital goods imports.	Sept.	+ 9%	Sept.	+ 17%	2.33	— 7%	Money supply expanding more rapidly.	**Tunisia**
Zaire	High external debt service payments seen stifling economic growth.	Sept.	+ 45%	6.2	220	Dec.	204	— 1%	3.1	217	Official cobalt price cut to $20 per pound as demand falters.	Oct.	+ 25%	Sept.	+ 27%	.3425	+ 4%	Credit to government in 1980 was below planned ceilings.	**Zaire**
Zambia	Low copper price deters mine expansion and maintenance.	Dec. '79	— 4%	3.2	572	Nov.	52	— 47%	0.8	377	Approximately $700 million arrears precludes access to essential imports.	June	+ 14%	Oct.	+ 2%	1.32	+ 8%	Foreign-exchange shortage near crisis level.	**Zambia**
Zimbabwe	Real economic growth this year could exceed last year's 8%.	Dec.	+ 14%	3.9	530	Dec.	264	— 6%	2.4	0	Growth of metals exports slackens, while agricultural exports accelerate.	Dec.	+ 8%	Dec.	+ 34%	1.55	+ 2%	Measures to restrain excess liquidity introduced.	**Zimbabwe**
Iran	Japanese to resume work on several projects.	Sept.	— 44%	n.a.	n.a.	June	15,478	+ 41%	n.a.	0	Oil output reported to be at least 1 million bpd; shipments to Japan resumed.	Nov.	+ 28%	Mar.	+ 32%	n. a.	—	Foreign-exchange reserves officially put at over $6 billion.	**Iran**
Iraq	Rise of 29% in investment spending to $17.9 billion officially projected for this year.	Oct.	+ 31%	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	0	Oil exports through Turkish and Syrian pipelines reportedly 900,000 bpd.	n.a.	n.a.	n.a.	n.a.	3.41	—	Credit generally available.	**Iraq**
Saudi Arabia	Official consumer price index rose 3.1% in IV Q 1980, up from 2.0% in like 1979 period.	Nov.	+ 71%	74.8***	11,510	Jan.	25,072†	+ 35%	10.6	0	Price of "war-relief" crude of 500-700,000 bpd hiked to $36 per barrel.	Sept.	+ 4%	Oct.	+ 14%	.2990	—	Riyal revalued again to 3.35 per dollar from 3.34.	**Saudi Arabia**
United Arab Emirates	Increased public-sector outlays will buoy private economic activity this year.	Nov.	+ 41%	13.8*	19,435	Jan.	2,400†	+106%	3.3	0	Japanese firms contract for 1.44 million tons per year of Abu Dhabi LPG.	n.a.	n.a.	Nov.	+ 16%	.2740	+ 2%	Bank credit to private sector expanding.	**United Arab Emirates**

Africa

Middle East

*1978 **1980 ***1978/79 †Excluding state reserves

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World Interest Rates

market rates of Mar. 11, 1981; bond yields as of Mar. 6, 1981

in percent per annum	U.S.	Canada	Britain	Belgium	France	Germany	Italy	Netherlands	Switzerland	Japan
Central Bank Discount Rate	13.00 penalty-large banks 16.00	17.16	12.00	12.00	9.50	7.50	16.50 penalty rate 19.50	9.00	4.00	7.25
Day-to-Day Money	14.50 Mar. 12	18.00	16.00	7.80	11.50	11.75	17.50	10.25	3.75	8.4375
Treasury Bills 91-day, Middle Rates	13.84	16.85	11.75	13.75	13.65 one-year	n. a.	15.498 77-day	no dealing	no market	5.875 two-month
Commercial Paper prime, 3-month, asked	14.75 finance paper	17.10 finance paper 15% tax w/h	11.406	11.50 Certified	12.375 Interbank	no market	no market	no market	no market	not traded
Bankers' Acceptances 3-month, asked	14.30	17.00 15% tax w/h	11.875	11.80 Certified	not traded	9.90	19.80	no market	4.50	no market
Government Bonds Long-term, new and old issues, average yield	12.57	14.00	14.02	11.476 20% tax w/h	14.425	10.41	16.71	11.80	5.45	8.23
Industrial Bonds prime, long-term, new and old issues, average yield	13.70 Aa Industrials	14.625	14.14	15.53	15.55	10.70	17.26	12.21	6.081	7.04
Bank Short-Term Rate to Best Borrowers (prime rate)	18.00	18.25	13.00	15.50	14.60	12.00	21.00 ⅛ quar'ly fee on outstdng.	12.50	6.00	7.50
Bank Time Deposits 3-month	14.75 Cert. of Dep.	17.00	12.625	13.75	12.5625	14.00	10.75	11.25 large deposits	8.5625 residents only	5.00 20% tax w/h
Eurocurrencies 3-month, asked	15.6875	no market	12.50	no market	12.375	12.875	no market	10.875	8.50	no market
Exchange Rates—in U.S.$ rates floating against the $	—	.8344	2.2100	.02881	.2004	.4720	.000975	.4269	.5165	.004820
Forward Exchange Cover 3-month, in percent p.a. *D* = discount, *P* = premium	—	1.00 *D*	2.375 *P*	1.75 *P*	3.00 *P*	2.75 *P*	2.875 *D*	4.75 *P*	7.25 *P*	8.00 *P*

Eurodollar Deposits
(London, interbank, bid)

March 5	
7-day	15.875
1-month	16.4375
3-month	16.625
6-month	16.625

International Arbitrage
(3-month, hedged) + *in favor of U.S. dollars*

U.S.-U.K. Treasury Bills	− .124
U.S.-Canada Treasury Bills	−1.02
U.S.-Canada Finance Co. Paper	−1.12
Eurodollars-U.K. Local Auth. Deposits	n. a.

Eurobonds
(average yield on recent straight debt issues)

U.S. Dollar Bonds	
7 yrs. and under	14.50
Over 7 yrs.	14.50
DM Bonds	
7 yrs. and under	9.75
Over 7 yrs.	10.00

Gold Price
London afternoon fixing
476.25
(per fine ounce)

The above interest rate quotations refer to the past week and may not be construed as offers by The Chase Manhattan Bank. The quotations for Bank Short-Term Rate to Best Customers, while including customary commissions, reflect neither possible other fees nor varying compensating balance requirements.

Pakistani Economic Indicators

	1977/78*	1978/79*	1979/80*	1980/81* projections	1981/82*
Real GDP Growth, %	7.0	6.0	6.2	5.5	6.0
Inflation, %	8.0	7.0	14.0	13.0	11.0
M2 Growth, %	21.8	20.6	18.8	16.0	15.0
Trade Balance (million $)	−1,464	−2,170	−2,416	−3,050	−3,200
Current-Account Balance (million $)	−630	−1,127	−1,125	−1,720	−1,765
Reserves/Average Monthly Imports	3.0	1.2	1.9	1.1	1.0
Debt Service/ Current Account Receipts	.11	.13	.14	.13	.12

* Fiscal year runs July 1 through June 30.

IMF Aids Pakistani Restructuring

Despite the economic growth advances of recent years, Pakistan's economy remains highly vulnerable. Among its problems are chronic budget and balance-of-payments deficits, extremely low agricultural productivity, and heavy dependence on external finance. At the same time, however, recent policy actions by the Pakistani Government have inspired the confidence of the International Monetary Fund. The IMF's $1.73-billion, three-year Extended Fund Facility loan is one of the largest ever granted a developing nation. And if the Pakistani leadership adheres fairly closely to the conditions outlined in the IMF arrangement, the economy should improve its standing by the end of the EFF program period.

Substantial progress, but problems persist

The Pakistani authorities have instituted major policy changes since 1977 to improve economic performance. In agriculture, greater attention has been paid to improving producer incentives and augmenting the availability of input supplies. In industry, the policy of extensive nationalizations and sharp restrictions on private-sector activity instituted in the early 1970s has been gradually reversed. Some spheres of activity previously closed to the private sector have been reopened, several public-sector enterprises have been returned to private hands, and a wide range of incentives have been introduced to spark private initiative. Attempts have been made to reform the remaining public-sector enterprises and to increase tax revenues. Subsidies have been reduced, incentives introduced to stimulate exports, and steps taken to lessen dependence on imported oil.

The economy has responded well to these measures. Inflation-adjusted economic growth averaged 6.4% in the period 1977/78-1979/80, more than double the annual population growth rate of 3%. Over the same period, agricultural output expanded by 4.2% on average, while manufacturing grew by an average 7.4% per annum, compared with annual growth rates of 1.6% and 2.8%, respectively, for the 1970/71-1976/77 period.

In fiscal 1979/80 alone (ended June 30, 1980), the Pakistani economy posted real growth of 6.2%. Agricultural production increased 6%, owing to strong cotton and wheat crops, and industrial output rose by 8.1%, fueled by improvement in the textile industry. On the external side, exports jumped 42% while import growth was held to 25%, leaving the country's current-account deficit virtually unchanged from the previous fiscal year's $1.1 billion.

Although this strong growth scenario would seem to imply that the shifts in policy achieved a solid economic rebound, they have failed to overcome serious fundamental weaknesses in the economy. These include:

- a population growth rate that makes increases in per capita income difficult and aggravates unemployment;
- poor agricultural productivity, with continued excessive reliance on favorable weather;
- weak private investment stemming from bureaucratic red-tape, unfavorable labor laws, and continued political uncertainty;
- a low and stagnant savings rate;
- chronic budget deficits resulting from income-inelastic revenues, heavy subsidization, and the inefficiency of public-sector enterprises;
- high inflation (officially estimated at 10%-11%, but privately estimated at 15% or higher);
- chronic balance-of-payments deficits, despite strong exports, import restrictions, and substantial foreign remittances;
- heavy dependence on external finance and a large debt service burden; and
- reliance on imported oil for domestic energy needs.

Thus, although the steps taken so far have been in the right direction, Pakistan has far to go before it finds itself on a steady and sustainable growth path. The IMF's three-year, $1.73-billion loan was granted specifically to aid in the effort at economic restructuring. In return, Pakistan agreed to: reorient its public-sector investment program to stress quicker-yielding projects; take steps to improve the profitability of public-sector enterprises; further slash subsidies to reduce the public-sector deficit; and restructure the budget revenue system to make it more responsive to increases in economic activity. The authorities have also imposed ceilings on the expansion of credit to the government, on overall domestic credit expansion, and on external borrowing by the public sector. Finally, to spur production and exports, significant import liberalization is to be pursued.

Additional public expenditures arising from supporting about 1½ million Afghan refugees, general defense, and the government's commodity operations may make it difficult for Pakistan to meet the IMF conditions with regard to paring the budget deficit and reducing deficit financing. And the authorities may not succeed in cutting subsidies as fast as the IMF deems desirable, for fear of generating internal

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unrest. Nonetheless, with prudence, Pakistan should be able to approximate the IMF ceilings.

The domestic outlook to 1982

Pakistan is expected to record real GDP growth of some 5.5% in fiscal 1980/81. Agricultural output looks set to expand by at least 4%, paced by large gains in wheat and sugarcane production. And industrial output is projected to be up by nearly 8%, with increases in textile output and sugarcane refining. Overall industrial activity will be spurred by greater access to imported inputs to production in the second half. With the higher level of economic activity, the services sector is likely to record real growth of about 6%.

In fiscal 1981/1982, agricultural output could rise by another 4%, assuming favorable weather. Industrial activity should continue stimulated by the import liberalization and could expand by 8.5%. And if the pace of services sector growth rises to 6.5%, Pakistan may record real GDP expansion of about 6%.

The policy of import liberalization is also expected to contribute to an easing of inflationary pressures. Pakistan's inflation rate accelerated to about 14% in 1979/80. With the economy relatively closed by the import restrictions instituted in October 1979, the excess supply of money that resulted put upward pressure on domestic prices, rather than flowing out through the purchase of goods from abroad. However, as the economy opens up through import liberalization, inflation should ease to the world level. The rate is expected to drop to about 13% in 1980/81 and further to 11% in 1981/82, even in the event of a small devaluation.

External-account deficits will widen

Pakistan's balance of payments is likely to deteriorate this year and next. Exports of cotton and rice—which account for one-third of total export receipts—are forecast to increase by about 12% in 1980/81; exports of manufactures look set to rise by only 14%, owing to the worldwide recession. Textile exports will likely continue constrained by restrictive import quotas in the United States and Europe. Overall, exports are projected to increase by only 13%.

The outlook for imports is unclear. The oil import bill is expected to reach $1.5-$1.6 billion in 1980/81, up from about $1.1 billion in 1979/80. But a great deal of uncertainty surrounds the magnitude of non-oil import growth that will be triggered by the liberalization of import restrictions. Imports of consumer goods will continue to be restrained, and the removal of curbs on imports of raw materials, intermediate inputs, and capital goods will be gradual. Nevertheless, pent-up demand is likely to be unleashed, and total imports are expected to increase by perhaps 20% in value terms in 1980/81. A trade deficit of $3 billion is forecast, but continued strong inflows of remittances will reduce the current-account deficit to $1.7 billion. Still, this represents a sharp widening from the current-account gap of $1.1 billion registered last year.

Fiscal 1981/82 should see strengthened export growth. Exports of manufactures should pick up as the world economy climbs out of recession and as imported inputs become more readily available. (A devaluation would further bolster competitiveness.) Overall, export earnings are projected to rise by about 16%. Import growth, on the other hand, could be held to 10%, based on the expectation of slower growth in imports of oil, raw materials, intermediate inputs, and capital goods—after their anticipated surge in fiscal 1980/81. The trade balance, however, is still likely to be in the red by about $3 billion, with the current-account gap expected to remain at around $1.7 billion, essentially unchanged from 1980/81. The current-account and trade balances should improve in subsequent years as exports strengthen in response to the liberalization of imports (and a likely devaluation). And later in the decade, oil imports may be cut significantly as attempts to boost domestic production of oil and natural gas begin to bear fruit.

The prospect of large current-account deficits in fiscal 1980/81 and 1981/82 points to the need for additional external finance. Public and publicly-guaranteed external debt, which is estimated to have risen to about $9.8 billion at the end of 1980, is projected to rise to about $11 billion by the end of 1981. In mid-January, the Aid-to-Pakistan Consortium granted Pakistan about $270 million in debt relief to be drawn down over an 18-month period. Additional aid, probably from other Islamic nations, is projected at about $200 million this year, and short-term commercial borrowings of $36 million are expected. Nevertheless, Pakistan's already low reserves are expected to decline by about $200 million this fiscal year and still further in 1981/82.

The Pakistani authorities have taken the appropriate steps at economic restructuring, and competent economic management promises continued progress. But the economy remains fragile. A severe balance-of-payments crisis looms as a possibility. And it will be difficult to spur private-sector activity sufficiently until political uncertainty is reduced—which is problematic. The economy's performance will also continue to hinge on favorable weather. Still, if the authorities adhere fairly closely to the IMF program, serious balance-of-payment difficulties should be avoided and the foundation laid for steady and sustainable economic growth in the latter part of the 1980s. *Melanie L. Lau*